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## **Fiscal Policy as an Engine of Economic Growth in Nigeria**

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### **Abstract**

*Economic growth is a powerful engine for generating long-term standard of living. There are many strategies through which a country may attain self-reliance. Fiscal policy has been identified as a means of generating growth. Taxation, major source of government revenue as well government expenditure are important channels of transmission between fiscal policy and growth. This paper employs basically a descriptive method to review the effect of fiscal policy in Nigeria. The study reveals that there are various challenges facing fiscal policy and tax implementation in Nigeria and that an appropriate method of tax implementation will increase the revenue of the country thereby accelerating economic growth. This paper submits that efficiency of tax system is not just a matter of appropriate tax laws but also the efficiency and integrity of tax administrators.*

**Key Words:** Fiscal policy, Tax, Expenditure, Economic Growth

### **Introduction**

One of the remarkable trends in contemporary history has been the importance in the growth of economic life. Any serious discussion of government is bound to raise the question about revenue and expenditure. Through appropriate tax, expenditure and regulatory policies, government seek to attain certain objectives. The achievement of macroeconomic goals namely, full employment, stability of price level, high and sustainable economic growth and external balance, from time immemorial, has been a policy priority of every economy whether developed or developing, given the susceptibility of macroeconomic variables to fluctuations in the economy. The realization of these goals is not automatic but requires policy guidance. The policy guidance represents the objectives of economic policy (Olawunmi & Ayinla 2007).

One of the regulatory policies used by government in achieving its objectives to bring about economic growth is fiscal policy. Fiscal policy is an outgrowth of Keynesian economics; its logical analysis suggests that it offers a sure-fire means of stabilizing the economy. The goal of modern fiscal policy is to achieve economic efficiency and stability. In a modern economy, no sphere of economic life is untouched by the government. Two major instruments or tools are used by government to influence private economic activity; taxes and expenditure.

The effect of taxation covers all the changes in the economy resulting from the imposition of a tax system. One may say that without taxation, a market economy would not attain certain production, consumption, investment, employment and other similar patterns. The presence of taxation modifies these patterns for good or for bad and such modifications may collectively be called the effect of taxation. Expenditure on the other hand, was meant to directly add to the effective demand in the market and generate a high-value multiplier by distributing income to those sections of the population which had a high marginal propensity to consume.

Government has the responsibility of preventing calamitous business depression by the proper use of fiscal and monetary policy, as well as close regulation of the financial system. In addition, government tries to smooth out the ups and downs of the business cycles, in order to avoid either large-

scale unemployment at the bottom of the cycle or raging price inflation at the top of the cycle. More recently, government has become concerned with financing economic policies which boost long-term economic growth. Because of the increasing importance of government conduct in a nation's development process, fiscal policy handles the issues of resource allocation and is preoccupied with the problems of economic growth, economic stability, employment, prices, income distribution and social welfare. Fiscal policy has developed an array of instruments to handle different facets of the economics of public sector. But by the very existence of multiplicity of goals, it is often bedevilled by inherent conflict of objectives; between long-term growth and short-term stability, between social welfare and economic growth, and between income redistribution and production incentives (Samuelson & Nordhaus 2005).

One of the most important objectives of macroeconomic policy in recent years has been the rapid economic growth of an economy. Economic growth is defined as "the process whereby the real per capita income of a country increases over a long period of time". Economic growth is measured by the increase in the amount of goods and services produced in a country. A growing economy produces more goods and services in each successive time period. Thus growth occurs when an economy's productive capacity increases which, in turn, is used to produce more goods and services. In its wider aspect, economic growth implies raising the standard of living of the people and reducing inequality of income distribution (Jhingan, 2003).

The relationship between government expenditure and economic growth has continued to generate series of debate among scholars. Some scholars argued that increase in government socio-economic and physical infrastructure encourages economic growth. For example, government expenditure on health and education raises the productivity of labour and increase growth of national output. Similarly expenditure on infrastructure such as roads, communications, power, etc., reduces production costs, increases private sector investment and profitability of firms, thus, fostering economic growth. Some scholars supporting this view concluded that expansion of government expenditure contributes positively to economic growth.

The intent of fiscal policy is essentially to stimulate economic and social development by pursuing a policy stance that ensures a sense of balance between taxation, expenditure and borrowing that is consistent with

sustainable growth. However, the extent to which fiscal policy engender economic growth continue to attract theoretical and empirical debate especially in developing countries.

In Nigeria, government expenditure has continued to rise due to the huge receipts from production and sales of crude oil, and the increased demand for public goods. Unfortunately, rising government expenditure has not translated to meaningful growth and development, as Nigeria ranks among the poorest countries in the world. In addition, many Nigerians have continued to wallow in abject poverty while so many live below the poverty line. Coupled with this, is dilapidated infrastructure (especially roads and power supply) that has led to the collapse of many industries, including high level of unemployment. Macroeconomic indicators like balance of payments, import obligations, inflation rate, exchange rate and national savings revealed that Nigeria has not fared well in the last couple of years.

In the light of the above scenario, the question that comes to the fore is what has been the effect of fiscal policy on the economic growth in the country over the years.

### **The Concept of Fiscal Policy**

Fiscal policy refers to that part of government policy concerning the raising of revenue through taxation and other sources and deciding on the level and pattern of expenditure for the purpose of influencing economic activities. It is a policy under which the government uses its expenditure and revenue programmes to produce desirable effects and avoid undesirable effects on national income, production and employment. The policy can also be seen as a deliberate spending and taxation actions undertaken by government in order to achieve price stability, to dampen the swings of business cycles, and to bring about nation's output and employment to desired levels (Jhingan, 2003).

Fiscal policy may be discretionary or non-discretionary. The discretionary fiscal policy is 'active' and it involves the conscious changes in government spending and taxes to create expansionary or contractionary effects. The non-discretionary fiscal policy is 'passive' which relies on automatic built-in stabilizers to keep the economy on course. There is need for government to stabilize the economy, specifically by adjusting the level and allocations of taxes and expenditure. Federal taxation and spending policies are designed to

level the business cycle and achieve full employment, price stability and sustained growth of the economy. Keynes opined that insufficient demand causes unemployment and excessive demand leads to inflation. It therefore, aims to stimulate demand and output in periods of business decline by increasing government purchases and cutting taxes, thereby releasing more disposable income into the spending stream, and to correct over expansion by reversing the process.

The Federal Government's policies on taxes and expenditure have a large impact on the economy. The theory of Keynes advocates the use of fiscal policy to offset imbalances in the economy. According to Keynes, a government should use fiscal policy to stimulate an economy slowed down by recession by through deficit, that is, by spending more than it collect from taxes. On the other hand, to slow down an economy that is threatened by inflationary pressures, there should be increase in taxes or cutting spending to create a budget surplus that would act as a drag on the economy.

Stabilization policy requires that policy makers can determine feasible targets, have a reasonable knowledge of the workings of instrumental variables and can effectively control the instrumental variables, the targets of those variable for which the government seek desirable values.

### **Objectives of Fiscal Policy**

Anyanwu and Oaikhenan (1995) clearly brought out the objectives of fiscal policy in Nigeria as follows:

- i) Generation of significant revenue for the government with which she can provide other services that benefit the entire society
- ii) Diversification of revenue sources away from crude oil-based revenues
- iii) Reduction in the tax burden on individuals and corporate bodies
- iv) Maintenance of economic equilibrium, particularly to control inflationary pressures, accelerate economic growth, reduce Balance of Payments deficits, and generate increased employment.
- v) Guaranteeing effective protection of domestic industries
- vi) Promotion of self-reliance development

- vii) Substantial progressive reduction and elimination of government budget deficit
- viii) Integration of the internal sector of the economy into the economic mainstream
- ix) Improving the effective control and efficiency in government fiscal operations, and hence promote transparency and accountability in the management of public finances.
- x) Coping with the twin problem of low productivity in agriculture and low capacity utilization in manufacturing.
- xi) Reduction of the heavy debt burden both external and internal loans, and minimization of existing inequalities in wealth, income and consumption standards which tend to undermine production efficiency, attend a sense of social justice and political stability.

#### **Functions of Taxation in Relation to Economic Growth and Development**

Taxation is a vital element in any country's economy: It is the source of funding for the important necessities such as education, health care, security and the million other things that are necessary to the safe running of a country.

Traditionally, taxation in developing countries has two major purposes. First, tax concessions and similar fiscal incentives have been thought of as a means of stimulating private enterprises. Such concession and incentives have typically been offered to foreign private investors to induce them to locate their enterprises in the less developed countries. The second purpose of taxation, the mobilisation of resources to finance public expenditure, is by far more important. Whatever the prevailing political or economic ideology of the less developed country, its economic and social progress depends largely on its government's ability to generate sufficient revenues to finance an expanding program of essential, non-revenue-yielding public services, health, education, transportation, legal and other institutions, poverty alleviation, and other components of the economy and social infrastructure, Torado and smith (2009).

Taxation influences key governance measures ranging from transparency, corruption, and more effective expenditures of revenues in the budget. Domestic resource mobilisation, in the form of progressive taxation can strengthen all of these areas and ultimately tackle the structural causes of poverty as well as the symptoms

Musgrave and Musgrave (2004) noted that it is evident that the role of fiscal system plays a multi-fold role in the process of economic growth. These roles include:

1. The level of taxation affects the level of public savings and thus the volume of resources available for capital formation.
2. Both the level and the structure of taxation affect the level of private saving.
3. Public investment is needed to provide infrastructure types of investment
4. A system of tax incentives and penalties may be designed to influence the efficiency of resource utilisation.
5. The distribution of tax burden (along with distribution of expenditure benefits) plays a large part in promoting an equitable distribution of the fruits of economic growth.
6. The tax treatment of investment from abroad may affect the volume of capital inflow and rate of earnings there from.
7. The pattern of taxation on imports and exports relative to that of domestic product will affect the foreign trade balance.

### **Fundamental Challenges of Fiscal Policy in Nigeria**

Taxes are the most important source of government revenue in modern economies. It is at the heart of the 'social contract' between a modern sovereign state and its citizens. In return for fulfilling duties such as 'paying a fair share of taxes', citizens are provided with security, infrastructure and social services. But in Nigeria, there is no strong commitment by both government and the citizens to their mutual responsibilities, and so the ability of the tax structure to yield substantial revenue is significantly reduced. Some of these challenges include:

- Weak administrative capacity for tax collection,
- Widespread corruption in tax collection

- Absence or dearth of public service benefits for previous tax payments which serve as a disincentive to continue tax payments
- Perceived mismanagement of public funds
- Pervasive tax avoidance and evasion
- Unfavourable attitudes towards paying tax
- Multiplicity of taxes and levies at the three tiers of government

According to Usman (2008), the past failure of fiscal policy in Nigeria in contributing to growth, wealth creation and poverty reduction can better be analysed within a framework of a commonly known term 'Natural Resource Curse'. This depicts a situation where a country endowed with vast amount of resources fails to translate such wealth into meaningful economic growth and development.

The failure of fiscal policy in Nigeria in the past to stimulate the economy from the volatility of oil revenue has led to undue real exchange rates appreciation with negative impact on the competitiveness of the economy, procyclical fiscal policy with adverse impact on the quality of government's expenditure, with detrimental effects on investment and growth.

There has always been the problem of the quality of spending with inefficiency and leakages in both current and capital budgets and also the problem of ill-conceived projects, as Nigeria tends to pay three times the cost of first class projects but end up with the third-class ones. Nigeria has engaged in unproductive public spending over the years which has brought a decrease on the rate of growth in the economy. Unproductive public spending in Nigeria takes various forms, including expenditure on the wages and salaries of unproductive employees. Such resources can be deployed to more productive initiatives that would enhance increase productivity in the economy.

Overall macroeconomic stability has not been sustained and there has not been emphasis placed on productivity investment. Despite calls for increase government's expenditure due to higher oil revenue and the temptation to respond by increasing government expenditure to match the increased revenues, greater caution should be exercised. Greater emphasis needs to be placed on planning, with a view of saving part of the higher oil revenue in an 'Oil Reserve Fund' to be used for properly formulated, designed and costed projects producing best values for money.



Fiscal policy has not been effective in the area of promoting sustainable economic growth in Nigeria. Factors such as policy inconsistency, high level of corruption, wasteful spending, poor policy implementation and lack of feedback mechanism for implemented policies evident in Nigeria are capable of hampering the effectiveness of fiscal policy. To put the Nigeria economy along the path of sustainable growth and development the government must put a stop to the incessant unproductive wasteful spending and embark upon specific policies aimed at achieving increased and sustainable productivity in all sectors of the economy.

### **Fiscal Policy and Economic Growth**

Economic growth is the basis of increased prosperity. Growth comes from the accumulation of capital (both human and physical) and from innovations which lead to technical progress. Accumulation and innovation raise the productivity of inputs into production and increase the potential level of output. The rate of growth can be affected by policy through the effect that taxation has upon economic decisions. An increase in taxation reduces the returns to investment (in both physical and human capital) and Research and Development (R&D). Lower returns mean less accumulation and innovation and hence a lower rate of growth. This is the negative aspect of taxation. Taxation also has a positive aspect.

Economic theory supports the idea that public spending and taxation are important channels of transmission between fiscal policy and growth. In the 1990s, development in the theory of growth recognized that there might be a larger role for public expenditure in determining an economy's growth rate. Some public expenditure affects the productivity of the private sector, other 'unproductive' expenditure only raise citizens' welfare or does neither, public provision of capital affects private production and some taxes distort investment decisions. Changes in expenditure composition, tax design and deficit financing might alter economy's growth path. The principal avenue for fiscal policy to influence growth comes from adopting a longer-term perspective. The range of options that are available with regard to tax and expenditure policies is necessarily restricted in the short-term. Longer-term horizon, however, provides both a better way to consider inter-temporal trade-offs and offers increased scope to shift expenditure and tax policies in ways that might be significantly more growth promoting.

Fiscal policy on government taxation and expenditure represents the bulk of public-sector activities. Most stabilization attempts have concentrated on cutting government expenditure to achieve budgetary balance. But the burden of resource mobilization to finance essential public developmental efforts must come from the revenue side. In the absence of well-organized and locally controlled money markets, most developing economies have had to rely primarily on fiscal measures to stabilize the economy and to mobilize domestic resources.

Ocran (2009) examined the effect of fiscal policy variables on economic growth in South Africa covering a period of 1990-2004, the study sought to examine the relationship between a selection of fiscal policy variables and economic growth. Vector auto regression model was used to estimate the effects of government consumption and investment expenditure, deficit and tax receipts on economic growth. The results supported the conclusions that, government consumption expenditure has a significant positive impact on output growth but the size of the impact is less than that attained by consumption expenditure, tax receipts also have a positive effect on output growth and lastly, the size of the deficit seems to have no significant impact on growth outcomes.

On the role of taxation the assertion is that tax induced distortions affects private agent's allocative decisions unfavourably in terms of factor accumulation and supply and hence may affect growth. This position is due to the assumption that all taxes save lump-sum taxes are non-neutral and distortionary. There is also debate about taxation as short-run fiscal policy instrument and its effect on long-term growth (Zagler and Durneker, 2003).

Public expenditure and taxation policies have implications for scope and incidence of government services, for growth and for income distribution. There is a consensus that macroeconomic stability is a necessary condition for growth but also a wide-spread condition that the design of stability programs should be improved to enhance growth prospect.

### **Fiscal Policy and Economic Growth in Nigeria**

Many Less Developed Countries face problems of large fiscal deficit- public expenditures greatly in excess of public revenue- resulting from a combination of ambitious development programme and unexpected negative external shocks. With rising debt burdens, falling commodity prices, growing

trade imbalances, and declining foreign private public investment inflows, a developing world government has little choice but to undergo several fiscal retrenchment. This meant cutting government expenditures (mostly on social services) and raising revenues through increased or more efficient tax collection (Torado and Smith 2009).

Efficient tax systems and expenditure pattern are crucial for the growth of the Nigerian economy. They contribute to financing the provision of public goods and contribute to state building and good governance.

The need to address the difficulties associated with fiscal policy has led to several reforms. Reforms have been undertaken over the years on existing fiscal policy in order to achieve some improvement on economic stability, but it seems the reforms might not have been on the right path to achieve the desired goal, as a result, the impact of fiscal policy in Nigeria is relatively low. The poor performance of government policy in achieving economic stability in Nigeria stemmed largely from the lack of recognition on the part of policy makers of the structure of the economy vis-a-vis the interrelationships between government's fiscal activities and macroeconomic variables. Stabilization policy requires that policy makers can determine feasible targets, have a reasonable knowledge of the workings of instrumental variables and can effectively control the instrumental variables, the targets of those variables for which the government seek desirable values.

Nigeria is a country that depends on mineral extraction, and it faces two challenges when formulating fiscal policy; in the long-run, the need to ensure that the fiscal stance is compatible with the sustainable use of oil and gas resources, and in the short run, the need to prevent the revenue volatility from spilling over into the budget. Since 1970, both revenue and expenditure have been volatile while increasing over time. In periods with high oil prices, revenue and expenditure have increased sharply. The implications of such boom-bust fiscal policies include the transmission of oil volatility to the rest of the economy as well as disruptions to the stable provisions of government services. This has added to the failure over the years of public spending neither facilitating the diversification and growth of non-oil sector nor reducing poverty (Baungard, 2003).

Nigeria often suffers high tax losses due to the structure of their economy, weak administrations, and inadequate tax policies. There have been a number of empirical studies on the relationship between fiscal policy and economic

growth in Nigeria. For instance, Ogiogio (1996) noted that the economy does not have the productive capacity to support growth in the absence of new government investment. In particular, it was agreed that government expenditure was necessary for the maintenance of existing infrastructure and the implication of policies/projects in the economic and social sector of the economy.

Okpanachi (2004) pointed out that the poor performance of government policies in achieving desired macroeconomic targets in Nigeria stemmed largely from the lack of recognition on the part of policy makers of the structure of the economy vis-à-vis the interrelationships between government's own fiscal activities and macroeconomic variables. Okpanachi went further to conclude that there is the need to overhaul the entire process of budgetary formulation, implementation and control. At the present a lot of expenditures escape the actual budgeting process. Apart from the lack of transparency that this entails, it also tends to make the budget a neutral document which it ought not to. Extra budgetary expenditures should be reduced to minimum levels if they cannot be completely eliminated. Every form of expenditure needs to be channelled through the budget. In this regard, budget monitoring and evaluation capacity needs to be strengthened as well.

Olaniyan (1997) pointed out that under ideal and perfectly competitive situations, economics policies for growth and stabilization should be employed in such a way as to equate the marginal productivity of government investment to that of private investment. This has to be so because the equilibrium situation in national income determination implies that resources employed in government investment activities should be as productive as in any alternative employment. However, Nigerian situation is far from ideal.

Olawunmi and Ayinla (2007) concluded in their study that, the achievement of sustainable economic growth through fiscal policy in Nigeria has remained a mirage. Despite the substantial increase in government expenditure over the years (1980-2004), the rate of economic growth has been very low and sluggish.

## **Conclusion**

The role of fiscal policy in securing stability and growth in Nigeria is of fundamental importance. Fiscal policy is a means of raising the domestic savings ratio. All tax revenue are useful in raising the level of domestic saving. The central problem of tax policy in Nigeria is how to obtain the necessary revenue while at the same time providing a correction for a typically high degree of inequality in the distribution of income, but without interfering unduly with private saving and investment.

There is need for new policies that look at other ways of sourcing new funds and the issue of mobilizing resources is important. The most strategic thing is the mobilization of domestic resources which are not fully utilized. This is where the issue of taxation comes into play. While external finance is attractive the danger is in accruing unnecessary and excessive debt burden. Taxation is emerging as most central to economic development agenda discourse compared to other development financing mechanisms like trade and aid as it provides a stable flow of revenues to finance development priorities. Beyond resource mobilisation, tax is an effective tool to enhance accountability between governments and the citizenry. Less attention is paid to citizens when governments are using more aid monies than their own funds. In this regards, governments should work towards involving the general populace on tax formulation as this is mostly viewed as the work of technocrats.

Government financial operations are well-nigh impossible without taxation. Apart from this, taxation can be a powerful means in order to achieve the goals of social progress and the objectives of economic development. It serves as a device to encourage the growth certain activities by way of giving exemptions, discourage use of certain products by way of imposing heavier charges like those sin taxes which are imposed upon tobacco products, or strengthen anaemic enterprises, also by way of tax exemptions. Local industries may be protected through taxation by imposing high customs duties to foreign goods. Moreover, taxation can also be used to reduce inequities or inequalities in wealth and income by progressively higher taxes as in the case of estate and income tax.

### **Recommendations**

Attaining macroeconomic balance has become a foremost necessity for Nigeria. Policy makers need to understand precisely, the interrelationships between fiscal policy and economic growth in Nigeria. Prudent fiscal policy as reflected in appropriate fiscal deficit and debt trend is to reduce the risk of economic crises, arising from the concerns relating to the government ability to meet its obligation. Such fiscal policy stance prevent interest expenditure from rising to levels that squeeze out critical social spending and ensure that the stock of debt remains at levels consistent with a country's capacity to its debt. Prudent fiscal policy as reflected in appropriate fiscal deficit and debt trend is to reduce the risk of economic crises, arising from the concerns relating to the government ability to meet its obligation. Such fiscal policy stance prevent interest expenditure from rising to levels that squeeze out critical social spending and ensure that the stock of debt remains at levels consistent with a country's capacity to its debt

- ❖ Efficient and fair tax systems are crucial for growth, poverty reduction, good governance and state-building. They tend to result in higher and more stable revenues, more sustainable investments, and improved competitiveness of economies
- ❖ Efficient and fair tax systems are also essential for promoting democracy and state legitimacy since tax payers tend to hold their governments accountable. They help build a strong fiscal, social contract between citizens and their government at all levels that encourages tax compliance, leads to improved democratic and economic governance, higher revenues through higher economic growth and broader tax bases.
- ❖ Greater emphasis needs to be placed on planning, with a view of saving part of the higher oil revenue in an 'Oil Reserve Fund' to be used for properly formulated, designed and budgeted projects producing best values for money.
- ❖ Development policy requires the existence and functioning of sound administrative machinery. No amount of development planning would have the intended effect if the required stability and level of administrative resources are not invested in their implementation.

- ❖ Tax incentives in the development strategy: Tax and investment incentives have in recent times become a favourite tool in development strategy both for domestic investors and for attracting foreign direct investment (FDI). The rationale for their use is that they constitute an important, if not a major, element in determining investment behaviour. Incentives increase the net of tax rates of returns and thereby reduce the need for large initial capital investment and also reduce risk. The availability of incentives tends to make otherwise unpromising and risky ventures more profitable. They are also valuable as an indirect stimulus to investment because they publicize and enhance the country's investment climate.
- ❖ Tax should be made comprehensive. It should encompass capital gains as well as income which takes the form of dividend interest, etc. it should extend to income from land and houses, including the imputed rent of owner-occupiers. It should avoid exemptions; such as interest on government bonds or mortgages.
- ❖ It cannot be emphasised too strongly that the efficiency of the tax system is not just a matter of appropriate tax laws but of the efficiency and integrity of tax administration. In Nigeria, the low revenue yield of taxation can only be attributed to the effect that the tax provisions are not properly enforced, either on account of the inability of the administration to cope with them, or on account of straight-forward corruption in the administration. No system of tax laws, however carefully conceived, is proof against collusion between tax administrations and the taxpayers. An efficient administration consisting of persons of high integrity is the most important requirement for exploiting the taxation potentials of a country.
- ❖ Government departments concerned with the administration of taxes should not be over-burdened and this in turn requires that complicated taxes should be avoided unless there is an administration able to cope with them. There are many different taxes with a negligible yield- the cumulative result of the gradual accretion of impost which have long since lost their justification, but which have never been formally withdrawn - the administration of which is a great deal more costly than the amounts collected.

Indeed, there is no other field where bureaucracy can be so cumbersome and absorb as in the administration of taxes, and in Nigeria there need to be an infusion of a new spirit, which makes it possible to apply modern techniques of business administration, before any major reform can be accomplished.

- ❖ Nigeria suffer both from an insufficiency of staff and from the relatively low grading of the staff of the administration departments. Persons of ability and integrity can only be found for these jobs if sufficient recognition is given to the importance of the task which they are asked to perform, and this should be fully reflected in their status, pay, prospects of promotion etc. Any additional outlay incurred in improving the status and pay of the officials of the revenue department is likely to yield a very high return in forms of increased revenue.

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